ANNEX A

CITY OF YORK COUNCIL

Executive **14 February 2019**

Report of the Deputy Chief Executive / Director of Customer and Corporate Services

Treasury Management Strategy Statement and Prudential Indicators for 2019/20 to 2023/24

Report Summary

1. The purpose of this report is to seek the recommendation of Executive to Full Council for the approval of the treasury management strategy and prudential indicators for the 2019/20 financial year.

Recommendations

2. Executive are asked to recommend that Council approve:
   - The proposed treasury management strategy for 2019/20 including the annual investment strategy and the minimum revenue provision policy statement;
   - The prudential indicators for 2019/20 to 2023/24 in the main body of the report;
   - The specified and non-specified investments schedule (annex B)
   - The scheme of delegation and the role of the section 151 officer (annex D)

   Reason: To enable the continued effective operation of the treasury management function and ensure that all council borrowing is prudent, affordable and sustainable.

Background

3. The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first function of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the council's low risk appetite, providing adequate liquidity initially before considering investment return.

4. The second main function of the treasury management service is funding of the council's capital programme. The capital programme provides a guide to

the borrowing need of the council, essentially the longer term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet council risk or cost objectives.

5. The contribution the treasury management function makes to the council is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

6. Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure),and are separate from the day to day treasury management activities.

7. CIPFA (Chartered Institute of Public Finance and Accountancy) defines treasury management as:

   "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks. "

8. Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital financing and investment strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital financing and investment strategy is being reported separately.

9. Our investments in commercial property to date have been relatively modest in the context of percentage of total budget but any future proposals to invest in property will need to be mindful of the extent to which they increase the percentage of our total income invested in this area.

Reporting requirements – Capital Strategy

10. The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:
    - a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
    - an overview of how the associated risk is managed
    - the implications for future financial sustainability

11. The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

12. This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:
    - The corporate governance arrangements for these types of activities;
    - Any service objectives relating to the investments;
    - The debt related to the activity and the associated interest costs;
    - The payback period (MRP policy);
    - The risks associated with each activity.

13. Where a physical asset is being bought, details of market research, advisers used, ongoing costs and investment requirements will be disclosed, including the ability to sell the asset and realise the investment cash.

14. Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

15. If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

Reporting requirements – Treasury Management

16. The council is currently required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. The three reports are:

- **Treasury mangement strategy statement and prudential indicators report** (this report) – which covers the capital plans including prudential indicators, the minimum revenue provision policy, the treasury managment strategy and the annual investment strategy;
- **Mid year treasury management report** – updates members as to whether the treasury activities are meeting the strategy, whether any policies require revision, amending prudential indicators if necessary;
- **Annual treasury report** – updates on treasury activity/ operations for the year and compares actual prudential indicators with estimates in the strategy.

17. These reports are required to be scrutinised before being recommended to the council. This scrutiny role is undertaken by Audit & Governance Committee.

18. The CIPFA code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. The training needs of treasury management officers is also periodically reviewed.

Treasury management strategy for 2019/20

19. The treasury managment strategy for 2019/20 covers two main areas:

Capital issues

- the capital programme and prudential indicators;
- minimum revenue provision (MRP) policy.

Treasury management issues

- prudential indicators which will limit the treasury management risk and activities of the Council;
- the current treasury position;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- creditworthiness policy;
- investment strategy;

- policy on use of external service providers;
- scheme of delegation and the role of the S151 officer

20. These elements cover the statutory and regulatory requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Ministy of Housing, Communities and Local Government (MHCLG) Minimum Revenue Provision (MRP) Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.

Treasury management consultants

21. The council uses Link Asset Services, Treasury solutions as its external treasury management advisors.
22. The council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.
23. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The capital prudential indicators 2019/20 – 2023/24

24. The council's capital expenditure plans are the key driver of treasury management activity and are the subject of a separate report on this agenda. The output of the capital programme is reflected in the capital prudential indicators, which are designed to assist member's overview of the council's capital programme to ensure that the capital expenditure plans are affordable, sustainable and prudent.
25. The capital prudential indicators along with the treasury management prudential indicators are included throughout the report:

    PI 1: Capital expenditure
    PI 2: Capital financing requirement
    PI 3: Ratio of financing cost to net revenue stream
    PI 4: External debt
    PI 5a: Authorised limit for external debt
    PI 5b: Operational boundary for external debt
    PI 5c: Housing revenue account (HRA) debt limit
    PI 6: Maturity structure of debt
    PI 7: Surplus funds invested >364 days

26. **Prudential indicator 1 - capital expenditure**. This prudential Indicator is a summary of the council's capital expenditure plans forming part of this budget cycle. 2018/19 is included as a comparator. Detailed information on the individual schemes is provided in the capital monitor 3 and capital strategy report.

Capital Expenditure	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
General fund (Non HRA)	81.4	196.1	101.7	58.5	17.5	11.1
Housing revenue account	24.9	35.6	26.5	10.9	9.2	8.7
Total	**106.3**	**231.7**	**128.2**	**69.4**	**26.7**	**19.8**

Table 1: Capital expenditure

27. Table 1 details the capital expenditure of the council, based on the capital programme strategy report, excluding other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments. There are no new PFI schemes forecast to be entered into in 2019/20.

28. Further details on this capital expenditure, and how it is funded, are included within the Capital Programme report elsewhere on this agenda.

29. **Prudential indicator 2** - **the capital financing requirement (CFR) (council's borrowing need);** the second prudential indicator is the council's capital financing requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

30. The CFR does not increase indefinitely, because the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

31. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the council's overall borrowing requirement, these types of scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. As set out in paragraph 49 table 5 the projected level of debt is significantly below the CFR over the 5 year period.

32. Table 2 below, shows the capital financing requirement, excluding other long term liabilities:

Capital	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**

Financing Requirement	Estimate £m	Estimate £m	Estimate £m	Estimate £m	Estimate £m	Estimate £m
Non Housing	**226.3**	**269.3**	**282.4**	**299.9**	**293.9**	**281.7**
Housing	**139.0**	**139.0**	**139.0**	**139.0**	**139.0**	**139.0**
Other Long Term Borrowing*	**46.5**	**44.9**	**43.1**	**41.3**	**39.4**	**37.7**
Total CFR	**411.8**	**453.2**	**464.5**	**480.2**	**472.3**	**458.4**

*Other Long Term is for PFI/PPP

Table 2: Capital financing requirement (CFR)

Minimum revenue provision (MRP) policy statement

33. The council is required to pay off an element of the accumulated general fund capital expenditure each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

34. MHCLG regulations require full council to approve an MRP statement in advance of each year. A variety of options are provided to councils, so long as there is prudent provision. Full Council is recommended to approved the following MRP statement:

35. For capital expenditure incurred before 1 April 2008 the MRP policy will be:

    - **Asset life method (local approach)** - MRP will be based on the average life of the overall asset base of 33 years. This will be calculated as 3% on a fixed, straight line basis.

36. This provides for a 3% reduction in the borrowing need (CFR) each year.

37. From 1 April 2008 for all borrowing (including PFI and finance leases) the MRP policy will be:

    - **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction);

38. This option provides for a reduction in the borrowing need over approximately the asset's life. The asset life is an absolute maximum and wherever possible debt is repaid over a shorter period. Estimated asset life periods will be determined under delegated powers. With all debts, the longer the repayment period the higher the amount of interest incurred over the period of the loan and accordingly it is deemed prudent to reduce the period over which the repayments are made.

39. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

40. Repayments included in annual PFI or finance leases are also applied as MRP.

Affordability prudential indicators

41. The prudential indicators mentioned so far in the report cover the overall capital programme and the control of borrowing through the capital financing requirement (CFR), but within this framework prudential indicators are required to assess the affordability of capital investment plans. These provide an indication of the impact of the capital programme investment plans on the council's overall finances.

42. **Prudential indicator 3 - ratio of financing costs to net revenue stream.** This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) and compares it to the council's net revenue stream.

Financing Costs	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %
Non-HRA	**11.14**	**11.92**	**15.74**	**17.93**	**20.31**	**19.88**
HRA	**13.25**	**13.25**	**13.25**	**13.25**	**13.25**	**13.25**
Total Ratio	**11.58**	**12.20**	**15.22**	**16.96**	**18.84**	**18.50**

Table 3: Ratio of financing costs to net revenue stream

43. The estimates of financing costs include current commitments and the proposals in the capital budget report considered elsewhere on this agenda.

44. The capital prudential indicators set out above ensure that the council's capital expenditure plans are affordable, sustainable and prudent. The treasury management function ensures that cash is available to meet the council's requirements in accordance with the Local Government Act 2003 and relevant professional codes

45. The treasury management function involves both the forecasting of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the prudential / treasury indicators, the current and projected debt positions and the annual investment strategy.

Current portfolio position

46. The council's treasury portfolio position at 31st December 2018 is detailed below in table 4:

Institution Type	Principal	Average Rate
Public Works Loan Board PWLB (57) – Money borrowed from the Debt Management Office (Treasury Agency)	£235.1m	3.64%
Market Loans Club loan (1) – A loan taken in conjunction with 2 other authorities LOBO Loans (1) – Lender Option Borrower Option West Yorkshire Combined Authority WYCA (4) – Zero interest loans the purpose of which are to help to fund York Central infrastructure projects	£10.0m £5.0m £2.4m	7.15% 3.88% 0.00%
Total Gross Borrowing (GF & HRA)	**£252.5m**	**3.75%**
Total Investments	**£77.8m**	**0.81%**

Table 4: Current position at 31st December 2018

47. The council had £252.5m of fixed interest rate debt, of which £139.0m was HRA and £113.4m general fund. The cash balance available for investment was £77.8m. As the capital programme has progressed the level of cash available for investment is gradually decreasing as expected as the Council is using previously held balances to fund the programme.

48. Within the prudential indicators, there are a number of key indicators to ensure that the council operates its activities within well defined limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. One of these is that the council needs to ensure that its total gross debt does not, except in the short term, exceed the total of the capital financing requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows the flexibility to borrow in advance of need but ensures that borrowing is not undertaken for revenue purposes.

49. **Prudential indicator 4 – external debt** Table 5 shows that the estimated gross debt position of the council does not exceed the underlying capital borrowing need. The Director of Customer & Corporate Services (s151 officer) confirms that the council complies with this prudential indicator and does not envisage difficulties for the future.

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Gross projected debt	**289.0**	**281.3**	**316.6**	**334.7**	**361.2**	**355.2**
Total CFR	411.8	453.2	464.5	480.2	472.3	458.4
Under/(over) borrowed	**Under**	**Under**	**Under**	**Under**	**Under**	**Under**

Table 5: External debt< capital financing requirement

50. Table 5 shows a gap between actual and estimated borrowing and the CFR (driven by the use of internal funds to finance capital expenditure). The decision as to whether to continue to do this will take into account current assumptions on borrowing rates and levels of internal reserves and balances held by the council. The figures above show an increase in the gap between CFR and external debt, however this will be determined by the s151 officer and the figure above is a current broad assumption. Actual borrowing will be determined by the circumstances that prevail at the time on borrowing rates and levels of cash balances.

Prudential indicators: limits on authority to borrow

51. **Prudential indicator 5A – authorised borrowing limit** - It is a statutory duty under Section 3 (1) of the Local Government Act 2003 and supporting regulations, for the council to determine and keep under review how much it can afford to borrow. This amount is termed the “authorised borrowing limit”, and represents a control on the maximum level of debt. This is a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full council. It reflects the level of external debt, which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

Authorised Limit	2018/19 (set at 18/19 Strategy) £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Borrowing	289.0	281.3	316.6	334.7	361.2	355.2

Total CFR	411.8	453.2	464.5	480.2	472.3	458.4
Operational Boundary	450.3	463.2	474.5	490.2	482.3	468.4
Other long term liabilities	30.0	30.0	30.0	30.0	30.0	30.0
Total	**480.3**	**493.2**	**504.5**	**520.2**	**512.3**	**498.4**

Table 6: Authorised borrowing limit

52. **Prudential indicator 5B – operational boundary**. In addition to the "authorised borrowing limit", the operational boundary is the maximum level of debt allowed for on an ongoing operational purpose. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational Boundary	2018/19 (set at 18/19 Strategy) £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Borrowing	289.0	281.3	316.6	334.7	361.2	355.2
Total CFR	411.8	453.2	464.5	480.2	472.3	458.4
Short term liquidity	10.0	10.0	10.0	10.0	10.0	10.0
Total	**450.3**	**463.2**	**474.5**	**490.2**	**482.3**	**468.4**

Table 7: Operational boundary

53. Separately, the council has previously been limited to a maximum HRA CFR through the HRA self-financing regime, known as the HRA debt limit or debt cap. As part of the 2018 UK National Budget on 29 October 2018 the debt cap for the HRA was lifted with immediate effect. However, the capital programme for the HRA will continue to comply with the requirements of the CIPFA prudential code in that capital expenditure and any associated financing implications must be affordable, prudent and sustainable.

54. The setting of internal prudential borrowing limits for the HRA will be required such that the annual cost of financing debt remains affordable. A report was presented to Executive in January 2019 that set out the implications of this change and approved in principle the appropriation of sites within the Housing Delivery Programme from the General Fund into the HRA, noting the increased debt that would occur, with sites to be appropriated following Executive approval of individual site business cases.

As and when these individual business cases are approved this will be reflected in the HRA debt limits and reported to the Committee.

HRA Debt Limit	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Total debt cap	**146.0**	**146.0**	**146.0**	**146.0**	**146.0**	**146.0**
HRA CFR	**139.0**	**139.0**	**139.0**	**139.0**	**139.0**	**139.0**
HRA headroom	**7.0**	**7.0**	**7.0**	**7.0**	**7.0**	**7.0**

Table 8: HRA debt limit

Prospects for interest rates

55. Current interest rates and the future direction of both long term and short term interest rates have a major influence on the overall treasury management strategy and affects both investment and borrowing decisions. To facilitate treasury management officers in making informed investment and borrowing decisions, the council has appointed Link Asset Services as its treasury adviser. Part of their service is to assist the council in formulating a view on interest rates. Table 9 below gives Link's central view:

	Bank rate %	PWLB borrowing rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2017	0.50	1.50	2.80	2.50
Mar 2018	0.50	1.60	2.90	2.60
Jun 2018	0.50	1.60	3.00	2.70
Sep 2018	0.50	1.70	3.00	2.80
Dec 2018	0.75	1.80	3.10	2.90
Mar 2019	0.75	1.80	3.10	2.90
Jun 2019	0.75	1.90	3.20	3.00
Sep 2019	0.75	1.90	3.20	3.00
Dec 2019	1.00	2.00	3.30	3.10
Mar 2020	1.00	2.10	3.40	3.20
Dec 2020	1.25	2.30	3.60	3.40
Mar 2021	1.25	2.30	3.60	3.40

Table 9 – Link's interest rate forecast

56. The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowly significantly during the last quarter. At their November quarterly inflation report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead

of the deadline in March for Brexit. On the assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

57. The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. Equity prices have been very volatile on alternating good and bad news during this period.

58. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

59. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates

60. Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

61. Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have back tracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

62. There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

Borrowing strategy

63. The borrowing strategy takes into account the borrowing requirement, the current economic and market environments and is also influenced by the interest rate forecast. The council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the capital financing requirement), has not been fully funded with loan debt as cash supporting the

council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains prudent as investment returns are low and counterparty risk is relatively high.

64. It is therefore beneficial to have a borrowing strategy where consideration is given to taking some longer term borrowing if favourable rates arise and also use some cash reserves. External borrowing will be considered throughout the financial year when interest rates seem most favourable. A target interest rate is 4.50%. This will enable borrowing to be taken through the year at different time periods. Consideration will also be given to the maturity profile of the debt portfolio so the council is not exposed to the concentration of debt being in any one year.

65. Against this background and the risks within the economic forecast, caution will be adopted with the treasury operations. The Director of Customer and Corporate Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

    - if it was felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
    - if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

66. The HRA strategy for borrowing will be the same as the borrowing strategy described above for the whole council. The HRA Business Plan will guide and influence the overall HRA borrowing strategy.

67. All decisions will be reported to the appropriate decision making body (Executive and Audit and Governance Committee) at the next available opportunity.

Prudential Indicator 6 – Maturity of borrowing

68. Officers will monitor the balance between variable and fixed interest rates for borrowing and investments to ensure the council is not exposed to adverse fluctuations in fixed or variable interest rate movements. This is likely to reflect higher fixed interest rate borrowing if the borrowing need is high or fixed interest rates are likely to increase, a higher variable rate exposure if fixed interest rates are expected to fall. Conversely if shorter term interest rates are likely to fall, investments may be fixed earlier, or kept shorter if short term investment rates are expected to rise.

69. The balance between variable rate debt and variable rate investments will be monitored as part of the overall treasury function in the context of the overall financial instruments structure and any under or over borrowing positions. The council does not currently have any variable rate debt.

70. The upper and lower limits for the maturity structure of fixed rate borrowing are set out below (with actual split for the current financial year included for comparison). This gross limit is set to reduce the council's exposure to large fixed rate sums falling due for refinancing in a confined number of years.

Maturity structure of borrowing				
	Lower	**Upper**	**2018/19 Debt (%)**	**2018/19 Debt (£)**
Under 12 months	0%	30%	9%	£21.0m
12 months to 2 years	0%	30%	4%	£10.0m
2 years to 5 years	0%	40%	6%	£15.7m
5 years to 10 years	0%	40%	25%	£63.9m
10 years and above	30%	90%	56%	£141.8m
Total Borrowing			100%	£252.4m

Table 10: Maturity structure of borrowing at 31st December 2018

Policy on borrowing in advance of need

71. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds..

72. Borrowing in advance will be made within the constraints of the CIPFA Prudential Code that:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period; and
- The authority would not look to borrow more than 36 months in advance of need

73. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt rescheduling

74. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However,

these savings will be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

75. The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

76. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

77. All rescheduling will be reported to the Executive / Audit & Governance Committee at the earliest meeting following its action.

Municipal Bond Agency

78. The establishment of the UK Municipal Bonds Agency was led by the Local Government Association (LGA) following the 2010 Autumn Statement which resulted in higher PWLB rates, greatly increasing the cost of new borrowing and refinancing. The purpose of the Agency is to deliver cheaper capital finance to local authorities. It will do so via periodic bond issues and by facilitating greater inter-authority lending. The Agency is wholly owned by 56 local authorities and the LGA. The council is a shareholder in the Agency with a total investment of £40k and will make use of this new source of borrowing as and when appropriate.

Annual investment strategy

Investment policy – management of risk

79. The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

80. The Council's investment policy has regard to the following:

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

81. The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

82. The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

i. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

ii. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

iii. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

iv. This authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in annex B under the categories of ‘specified’ and ‘non-specified’ investments.

   - Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
   - Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

v. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix tables in annex B.

vi. Transaction limits are set for each type of investment.

vii. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see annex C).

viii. This authority has engaged external consultants, (see paragraphs 21 to 23), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

ix. All investments will be denominated in sterling.

x. As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)

83. However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 93). Regular monitoring of investment performance will be carried out during the year.

Creditworthiness policy

84. This council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modeling approach with credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies
- CDS spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

85. This approach combines credit ratings, credit watches, credit outlooks in a weighted scoring system which is then combined with an overlay of CDS (credit default swap) spreads for which the end product is a series of colour code bands, which indicate the relative creditworthiness of counterparties. These colour codes are also used by the council to determine the duration for investments. The council will therefore use counterparties within the following durational bands:

- Yellow* 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or part nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

**The yellow category is for UK Government debt or its equivalent (government backed securities) and AAA rated funds*

86. The Link Asset Services creditworthiness model uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue weighting to just one agency's ratings.
87. Typically the minimum credit ratings criteria the council use will be a short term rating (Fitch or equivalents) of F1 and Long Term rating A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
88. All credit ratings are monitored on a daily basis. The council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service:
    - If a downgrade results in the counterparty/investment scheme no longer meeting the council's minimum criteria, its further use as a new investment will be withdrawn immediately.
    - In addition to the use of credit ratings the council will be advised of information in movements in credit default swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the councils lending list.
89. Although sole reliance is not placed on the use of this external service, as the council uses market data and market information, information on government support for banks and the credit ratings of that supporting government, the suitability of each counterparty is based heavily on advice from Link.
90. Whilst the council has determined that it will not limit investments to UK banks, it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in annex C. This list will be added to or deducted from by officers should ratings change in accordance with this policy.

Investment strategy

91. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainableby investing for longer periods. While most cash balances are required in order to manage ups and downs of cash flow, where cash sums can be

identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

92. On the assumption that the UK and EU agree a Brexit deal in spring 2019, then Bank rate is forecast to increase steadily but slowly over the nest few years to reach 2% by quarter 1 2022. Bank rate forecasts for financial year ends (March) are:

2019/20	1.25%
2020/21	1.50%
2021/22	2.00%

93. For its cash flow generated balances, the council will seek to utilise a combination of business reserve accounts (call accounts), short notice accounts, short dated fixed term deposits and money market funds. In addition, the council will look for investment opportunities in longer dated term deals with specific counterparties that offer enhanced rates for local authority investment. All investment will be undertaken in accordance with the creditworthiness policy set out above.

94. The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next three years are as follows:

2019/20	1.00%
2020/21	1.50%
2021/22	1.75%

95. Therefore for 2019/20, the council has budgeted for an investment return target of 1.00% on investments placed during the financial year and uses the 7 day LIBID rate as a benchmark for the rate of return on investment.

96. **Prudential indicator 7** - total principal investment funds invested for greater than 364 days. This limits is set with regards to the council's liquidity requirements and are based on the availability of funds after each year-end. A maximum principal sum to be invested for greater than 364 days is £15m.

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Maximum limit per year for Investments > 364 days	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**	**15.0**

Table 11: Maturity structure of borrowing

97. At the end of the financial year, the council will report on its investment activity as part of its annual treasury report. It should be noted that the

Investment policy, creditworthiness policy and investment startegy are applicable to the council's overall surplus funds and are also applicable to the HRA.

Consultation and options

98. The treasury management function of any business is a highly technical area, where decisions are often taken at very short notice in reaction to the financial markets. Therefore, to enable effective treasury management, all operational decisions are delegated by the council to the Director of Customer & Corporate Services, who operates within the framework set out in this strategy and through the treasury management policies and practices. In order to inform sound treasury management operations the council works with its treasury management advisers, Link Asset Services. Link Asset Services offers the council a comprehensive information and advisory service that facilitates the council in maximising its investment returns and minimise the costs of its debts.

99. Treasury management strategy and activity is influenced by the capital investment and revenue spending decisions made by the council. Both the revenue and capital budgets have been through a corporate process of consultation and consideration by the elected politicians. The revenue budget and capital budget proposals are included within this agenda.

100. At a strategic level, there are a number of treasury management options available that depend on the council's stance on interest rate movements. The report sets out the council's stance and recommends the setting of key trigger points for borrowing and investing over the forthcoming financial year.

Council Plan

101. The treasury management strategy statement and prudential indicators are aimed at ensuring the council maximises its return on investments and minimises the cost of its debts whilst operating in a financial environment that safeguards the councils funds. This will allow more resources to be freed up to invest in the council's priorities, values and imperatives, as set out in the Council Plan.

Implications

Financial

102. The financial implications of the treasury strategy are set out in the Financial Strategy Capital Strategy reports also on this agenda.

Human Resources (HR)

103. There are no HR implications as a result of this report

Equalities

104. There are no equalities implications as a result of this report

Legal Implications

105. Treasury management activities have to conform to the Local Government Act 2003, the Local Authorities (Capital; Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), which specifies that the council is required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice and also the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414), which clarifies the requirements of the Minimum Revenue Provision guidance.

Other implications

106. There are no crime and disorder, information technology or property implications as a result of this report

Risk management

107. The treasury management function is a high-risk area because of the volume and level of large money transactions. As a result of this the Local Government Act 2003 (as amended), supporting regulations, the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice (the code) are all adhered to as required.

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<tr><td colspan="4">Wards Affected: Not Applicable</td><td></td></tr>
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For further information please contact the author of the report

Background papers

none

Annexes
Annex A – Interest rate forecast
Annex B – Specified and non-specified investments categories schedule
Annex C – Approved countries for investments
Annex D – Scheme of delegation and the role of the section 151 officer

ANNEX A
Annex A - interest rate forecast 2019-2021

Link Asset Services Interest Rate View

	Mar 2019	June 2019	Sept 2019	Dec 2019	Mar 2020	June 2020	Sept 2020	Dec 2020	Mar 2021	June 2021	Sept 2021	Dec 2021
Bank Rate	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%
5yr PWLB rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%
10yr PWLB rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%
50yr PWLB rate	2.70%	2.90%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%

Specified and non-specified investments categories Annex B

A variety of investment instruments will be used, subject to the credit quality of the institution, to place the council's surplus funds. The criteria, time limits and monetary limits applying to institutions or investment vehicles are listed in the tables below.

Investments are split into two categories of specified investments and non-specified Investments. Specified investments are relatively high security and high liquidity investments, which must be sterling denominated and with a maturity of no more than a year. Non-specified investments are those investments with a maturity period of greater than one year or are still regarded as prudent but may require more detailed scrutiny and assessment procedures.

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this council. To ensure that the council is protected from any adverse revenue impact, which may arise from these differences, treasury officers will review the accounting implications of new transactions before they are undertaken.

Specified investments:

Counterparty type	Minimum 'high' credit criteria/colour band	Maximum investment limit per counterparty institution	Maximum maturity period
DMADF – UK Government	UK sovereign rating	£15m	6 months
UK Government Treasury Bills	UK sovereign rating	£15m	1 year
UK Government Gilts	UK sovereign rating	£15m	1 year
Term deposits - local authorities	UK sovereign rating	£15m	1 year
Part-nationalised UK Banks	Blue	£15m	1 year
Term Deposits - UK Banks and Building Societies	Orange Red Green	£15m £15m £8m	1 year 6 months 100 days
Term Deposits - Non-UK Banks (with a sovereign rating of AA-)	Orange	£15m	1 year
Certificates of Deposits issued by Banks and Building Societies	Orange/Blue	£15m	1 year
Collective investment schemes structured as open ended investment companies (OEICs) as below:-			

1. Money Market Funds CNAV	AAA	£15m	Liquid
2. Money Market Funds LVNAV	AAA	£15m	Liquid
3. Money Market Funds VNAV	AAA	£15m	Liquid
4. Ultra-Short Dated Bond Funds	AAA	£15m	Liquid
5. Bond Funds	AAA	£15m	Liquid

CNAV – constant net asset value
LVNAV – low volatility net asset value
VNAV – variable net asset value
NON-SPECIFIED INVESTMENTS*:*

A maximum of 100% can be held in aggregate in non-specified investment

1. Maturities of ANY period

Counterparty type	**Minimum credit criteria**	**Maximum investment limit per counterparty institution**	**Maximum Maturity Period**
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Orange Blue Red Green	£15m £15m £15m £8m	1 Year 1 year 6 months 100 days
Certificates of Deposits issued by Banks and Building Societies	Red Green	£15m £8m	6 months 100 days
Floating Rate Notes	Long-term AAA	£15m	1 year
Property Funds: *the use of these investments may constitute capital expenditure*	AAA-rated	£15m	5 years

2. Maturities in excess of 1 year

Term Deposits– local authorities	UK Sovereign Rating	£15m	> 1 year
Term deposits – Banks and Building Societies	Yellow Purple	£15m £15m	5 years 2 years
Certificates of Deposits issued by Banks and Building Societies not covered by UK Government guarantee	Yellow Purple	£15m £15m	5 years 2 years
UK Government Gilts	UK sovereign rating	£15m	> 1 year

Collective investment schemes structured as open ended investment companies (OEICs) as below:-			
1. Bond Funds	Long-term AAA	£15m	> 1 year
2. Gilt funds	Long-term AAA	£15m	> 1 year

Approved countries for investments **Annex C**

AAA

- Australia
- Canada
- Denmark
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland
- United States of America

AA+

- Finland

AA

- France
- United Arab Emirates
- United Kingdom

AA-

- Belgium
- Qatar

Treasury management scheme of delegation **Annex D**

(i) Executive / Full Council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy and annual outturn

(ii) Executive

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities

(iii) Audit & Governance Committee

- receiving and reviewing reports on treasury management policies, practices and activities
- reviewing the annual strategy, annual outturn and mid year review.

(iv) Director of Customer and Corporate Services (section 151 officer)

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.
- all operational decisions are delegated by the council to the Director of Customer & Corporate Services, who operates within the framework set out in this strategy and through the treasury management policies and practices
- Approving the selection of external service providers and agreeing terms of contract in accordance with the delegations in financial regulations.

The treasury management role of the section 151 officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- all operational decisions delegated by the council to the Director of Customer & Corporate Services (s151 officer), who operates within the framework set out in this strategy and through the treasury management policies and practices
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit

- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following*: -*
    - *Risk management, including investment and risk management criteria for any material non-treasury investment portfolios;*

    - *Performance measurement and management, including methodology and criteria for assessing the performance and success of non-treasury investments;*

    - *Decision making, governance and organisation, including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

    - *Reporting and management information, including where and how often monitoring reports are taken;*

    - *Training and qualifications, including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*